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New Strategies are Needed to Resolve Growing Software Pricing Problems

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During the past several decades, the $220 billion global software industry has proven itself dynamic and lucrative. But it now faces a serious economic threat, exacerbated by today's challenging economic times, focused on the wild and win-obsessed world of software pricing. Here's the sobering truth: the software industry's pricing practices lag several other industries in sophistication, automation and effectiveness.

The enterprise software industry, which provides products for large corporations, has suffered from a frenetic, often irrational price discounting conundrum. Vast numbers of software buyers have too often been able to negotiate lower prices for software they purchase from software vendors by waiting to buy until the end of the sales quarter. This is when software sales reps feel the most heat to reach their quarterly sales targets.

In Accenture's day-to-day consultation with corporate clients, we have learned that software buyers are securing discounts off vendors' list prices of 20 percent, 50 percent and sometimes up to 70 percent. Vendors, caught in pure haggling situations, are too frequently caving into the pressure, giving customers too much pricing power. But that's not all. To ensure they close a sale, these sales people often sweeten the offer by giving away other free software applications, capabilities and high value technologies to software buyers.

Often, millions of dollars of research and development expense have been invested in those freebies sales people "throw in" to seal deals. These are too often last-minute, under-analyzed decisions that hurt the profitability of software companies by 'leaving money on the table.'

This discounting has been an escalating problem over the past year. Never has Accenture seen this situation so pervasive. For a growing number of software players, this is their biggest concern. Such is the enterprise software story in capsulated form.

Another area of growing concern is packaged software used for smaller applications. Typically, this software type runs on fewer computers, often PCs, and is less customized than enterprise software. The biggest problem in this market is the sheer enormity, variety and complexity of packaged software. There are literally hundreds of thousands of different software price points targeted for a multitude of disparate market segments, channels and geographies. Complexity rules.

This problem confounds and overwhelms people working in the business of pricing packaged software. There exists too much detailed and disorganized pricing information, such as pricing sheets and price adjustment forms, to sort through, analyze, compute, collate, compare and make decisions about compared with the limitations of time, people and funding. This problem, which began several years ago, has been worsening in severity during the past year.

In the cases of enterprise and packaged software, the obvious question is what should be done to solve these problems? And by this Accenture means how do software companies set prices more effectively for growing their profits and revenues, and delivering high performance in these challenging times? Following are three recommendations.

1. Don't Drop Prices Immediately

To become a high performance business, don't immediately pull the pricing lever by dropping prices. Be sure to consider pulling various other levers that deliver value to your customers besides price. For example, evaluate and identify your best customers and serve them in ways that they value.

Evaluate and pinpoint the differentiating value you deliver to them and the long-term worth of what you provide them. Focus on delivering a superior customer experience. This benefit has become so critical as a differentiator in the current communications and high-tech industries that delivering it may diminish the customer's desire and justification for pressuring you to lower prices.

Remember that with your best customers you can often be more flexible in your pricing strategies. You possess stronger negotiation leverage because of the strength, trust and goodwill inherent in the relationship.

2. Identify the Most Price-Sensitive Markets

Analyze and understand the different types of customer segments and geographic markets you serve. Understand where and how you want to make money in the software business, and price accordingly. Ascertain which markets you serve require that you reduce prices to compete effectively, and which do not. Examine and understand in a more disciplined way than you ever have the structure and critical processes and applications of the business you are in, and figure out which segments of your target market are more and less sensitive to your pricing changes. Precise customer and market segmentation is paramount to pricing success. Across the board pricing cuts for all software products makes no sense; some customer segments are more tolerant of higher prices than others.

Focus on software product pricing rules, formulas, structures and processes. Gain more knowledge, understanding and insight about what you sell. Then price accordingly. Factor in the total value of your set of offerings, not individual piece part products.

3. Be Willing to Lose Sales to Maintain Pricing Control

Be willing to lose a bid on a contract because you are not willing to lower your price. In most businesses, is not so crucial that you absolutely must have it. Think about this scenario: you win a sale by lowering price, but by doing so, you hurt your business long-term. If a sale requires that you lower your price so much that it hurts your overall profits and revenues, maybe it's not worth it to you. Don't turn the pricing power over to your customers.

These pricing issues should be viewed as great opportunities to re-examine what the structure of your software business is, what structure you want it to have in the future, and how and why you do and do not compete and differentiate.

Conclusion: Don't Destroy the Real and Perceived Value

There is a basic and crucial business axiom involving pricing, branding and value. The axiom is this: if a company drops its price of software in times of particular economic instability, that company exposes itself to the dire reality that when the market returns to a growth phase, it will be difficult to persuade customers that a price increase is justified. By reducing prices to sub-standard levels, companies cause a devaluation of their software products and brand and lose pivotal leverage to reclaim value for its software.

During these challenging economic times, cost containment and retention of your best customers are paramount to success. Pricing wisely is one pivotal way to achieve these compatible goals and achieve high performance.

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